REPORT ON EXAMINATION

OF THE

HUDSON INSURANCE COMPANY

AS OF

DECEMBER 31, 2004

I, Matthew Denn, Insurance Commissioner of the State of Delaware, do hereby certify that the attached REPORT ON EXAMINATION, made as of DECEMBER 31, 2004 of the

HUDSON INSURANCE COMPANY

is a true and correct copy of the document filed with this Department.

ATTEST BY: ______________________

DATE: 20 JUNE 2006

In Witness Whereof, I HAVE HEREUNTO SET MY HAND AND AFFIXED THE OFFICIAL SEAL OF THIS DEPARTMENT AT THE CITY OF DOVER, THIS 20TH DAY OF JUNE 2006.

____

Insurance Commissioner

REPORT ON EXAMINATION

OF THE

HUDSON INSURANCE COMPANY

AS OF

December 31, 2004

The above captioned Report was completed by examiners of the Delaware Insurance Department.

Consideration has duly been given to the comments, conclusions, and recommendations of the examiners regarding the status of the Company as reflected in the Report.

This Report is hereby accepted, adopted, and filed as an official record of this Department.

MATTHEW DENN
INSURANCE COMMISSIONER

DATED this 20TH Day of JUNE 2006.

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February 22, 2006

SALUTATION

Honorable Alfred W. Gross, Chairman
Financial Condition Subcommittee, NAIC
2301 McGee Street, Suite 800
Kansas City, Missouri 64108-2662

Honorable Merwin Stewart, Director
Secretary Western Zone
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Department of Insurance
State Office Building, #3110
Salt Lake City, Utah 84114-1201

Honorable Alfred W. Gross, Commissioner
Secretary Southeastern Zone
Commonwealth of Virginia
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Bureau of Insurance
P. O. Box 1157
Richmond, Virginia 23218

Honorable Susan F. Cogswell, Commissioner
Secretary Northeastern Zone
State of Connecticut
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Honorable Sally McCarty, Commissioner
Secretary-Treasurer Midwestern Zone
State of Indiana
Department of Insurance
311 W. Washington Street, Suite 300
Indianapolis, Indiana 46204-2787

Honorable Matthew Denn
Insurance Commissioner
State of Delaware
841 Silver Lake Boulevard, Suite 100
Dover, Delaware 19904

Commissioners:

In compliance with instructions and pursuant to statutory provisions contained in Certificate of Authority Number 05.012, an examination has been made of the affairs, financial condition and management of

HUDSON INSURANCE COMPANY

hereinafter referred to as “Company” or “Hudson” incorporated under the laws of the State of Delaware. The examination was conducted at the Company’s office located at 300 First Stamford Place, Stamford, Connecticut 06902-6040. The examination of the Company was conducted concurrently with that of its immediate parent, Clearwater Insurance Company (“Clearwater”). Separate reports of examination were filed for each company.

The report of examination thereon is respectfully submitted.

SCOPE OF EXAMINATION

The financial condition examination of the Company, covered the period from January 1, 2003 through December 31, 2004 and consisted of a general survey of the Company's business policies and practices; management, any corporate matters incident thereto; a verification and evaluation of assets and a determination of liabilities. Transactions subsequent to the latter date were reviewed to the extent deemed necessary.

The format of this report is designed to explain the procedures employed on the examination and the text will explain changes wherever made. If necessary, comments and recommendations have been made in those areas in need of correction or improvement. In such cases, these matters were thoroughly discussed with responsible personnel and/or officials during the course of the examination.

The general procedure of the examination followed rules established by the National Association of Insurance Commissioners (NAIC) Committee on Financial Condition Examiners Handbook as adopted by the Delaware Insurance Department under Delaware Insurance Code Section 526, and generally accepted statutory insurance examination standards.

In addition to items noted in this report, the following topics were reviewed and are included in the work papers of this examination:

Fidelity bond and other corporate insurance
Corporate records
NAIC ratios
Legal action
Schedule of examination adjustments
Subsequent events

HISTORY

The Company was incorporated on January 16, 1918, and commenced business on December 14, 1918 as a stock multi-line insurer under the laws of the State of New York. The Company was a direct writer until 1932 and became a professional reinsurer in 1935.

Skandia Insurance Company Ltd. of Stockholm, Sweden (SICL) acquired Hudson on August 25, 1939. On July 1, 1974, ownership was transferred to Clearwater formerly Odyssey Reinsurance Corporation, formerly Skandia America Reinsurance Corporation, the domesticated Company of the former United States branch of SICL.

On December 31, 1978, the Company re-domesticated from New York to Delaware by way of a merger into its wholly owned subsidiary, Hudson Insurance Company of Delaware. This subsidiary served as the corporate vehicle to accomplish the change of domicile. Subsequently, the certificate of incorporation was amended and the “of Delaware” was deleted from the corporate name with Hudson retaining all rights and privileges, powers and franchises of the former New York domiciled corporation.

The Delaware Insurance Commissioner, granting authority to conduct a multiple line insurance business, other than life, health, annuities and title, issued an amended Certificate of authority to the Company on February 26, 1979.

In 1981, the Company started to write excess and special risk business, however in July 1985, the Company suspended writings.

In 1990, the Company resumed writing direct excess and surplus lines business through one Managing General Agent in the State of Texas. During 1997, the Company suspended writings with this agent.

Fairfax Inc., a Wyoming Corporation, purchased the Company along with Clearwater its immediate parent, on May 31, 1996. The ultimate parent of Fairfax, Inc. is Fairfax Financial Holdings Limited, (Fairfax) a Canadian financial services holding company.

At December 31, 2004, Hudson was owned 100% by Clearwater Insurance Company, an insurance company domiciled in the State of Delaware. The latter is owned 100% by Odyssey America Reinsurance Corporation, a Connecticut corporation.

CAPITALIZATION

At December 31, 2004, as reported in its annual statement, the Company's authorized capital is $7,500,000 consisting of 25,000 issued and outstanding shares of common stock at a par value of $300 per share. The following changes occurred in the capital and surplus accounts since the prior examination.

	Common Capital Stock	Gross Paid-in and Contributed	Unassigned Surplus	Total
December 31, 2002	$ 7,500,000	$ 2,225,000	$ 11,101,319	$ 20,826,319
Operations: (1)				3,249,965
2003			(233,719)	
2004			3,483,684	
Capital changes: (2)				55,000,000
Surplus paid-in 2003		30,000,000		
Surplus paid-in 2004		25,000,000		
December 31, 2004	$ 7,500,000	$ 57,225,000	$ 14,351,284	$ 79,076,284

1. Operations is defined as Net income, Change in net unrealized capital gains or (losses), Change in net unrealized foreign exchange capital gain (loss), Change in net deferred income tax, Change in nonadmitted assets and Change in provision for reinsurance.
2. Capital changes were due to surplus contributions by the Company's parent.

MANAGEMENT AND CONTROL

Pursuant to the General Corporation Law of the State of Delaware as implemented by the Company's Certificate of Incorporation and By-Laws all corporate powers and its business, property and affairs are managed by or under the direction of its Board of Directors. The Board shall consist of eight members.

The members of the Board of Directors serving as of December 31, 2004, were as follows:

Director's Name	Principal Business Affiliation
Andrew Acheson Barnard *	Hudson Insurance Company
Robert Stanley Bennett	Hudson Insurance Company
Christopher Liam Gallagher	Hudson Insurance Company
James Edward Migliorini	Hudson Insurance Company
Donald Lee Smith	Clearwater Insurance Company
Charles Dominic Troiano	Clearwater Insurance Company
Michael Gerard Wacek	Clearwater Insurance Company
Brian David Young	Clearwater Insurance Company

* Chairman of the Board of Directors

The Company's By-Laws provide for the Board to designate one or more committees, each committee to consist of one or more of the directors of the corporation. As of December 31, 2004, the Board of Directors had appointed the following committees.

Investment Committee	Benefit Committee
Andrew A. Barnard	Andrew A. Barnard
Charles D. Troiano	Donald L. Smith
Michael G. Wacek	Michael G. Wacek

Compensation Committee

Andrew A. Barnard
Charles D. Troiano
Michael G. Wacek

None of the above committees held meetings evidenced by minutes.

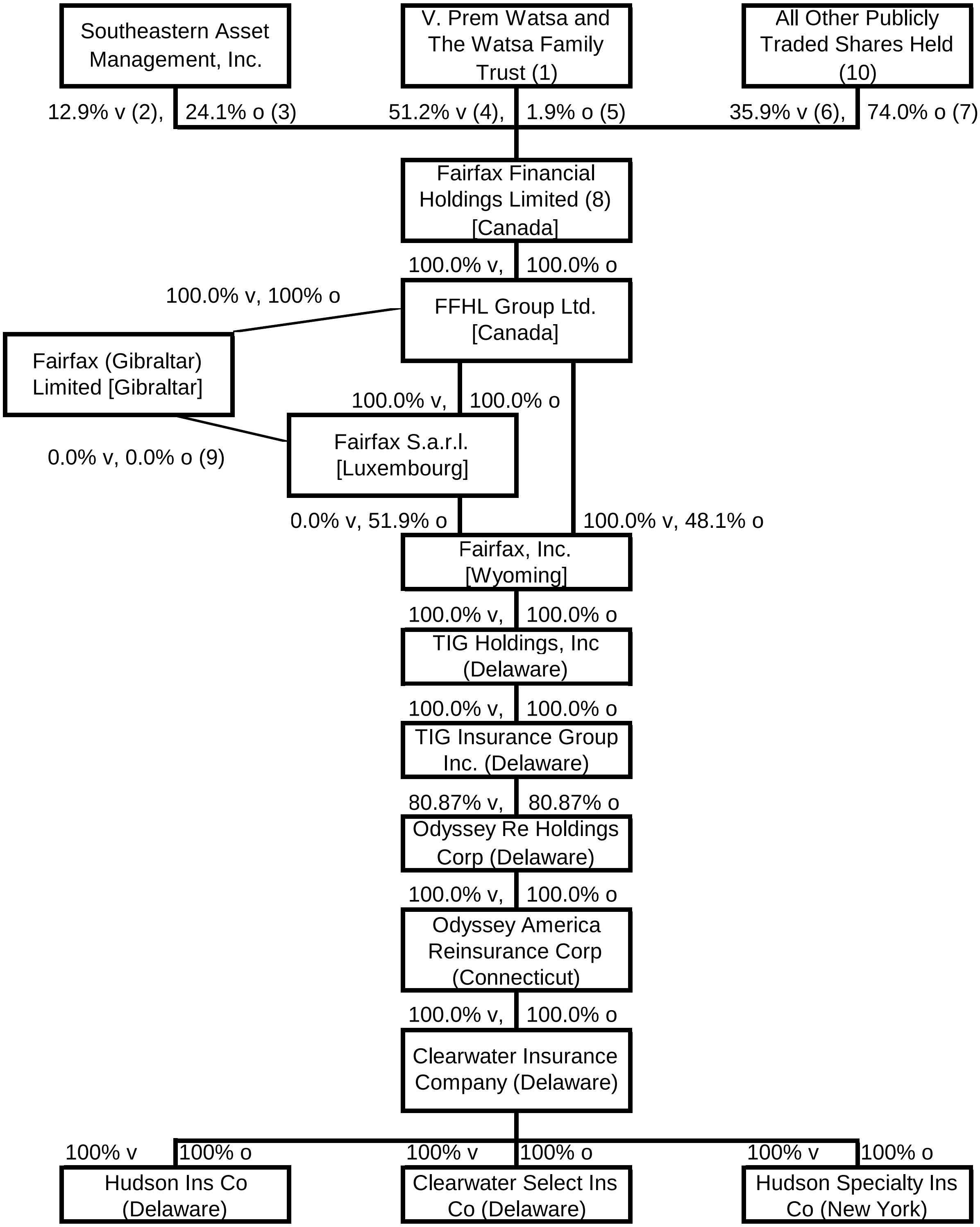
The By-Laws of the Company provide for a President, one or more Vice Presidents, one or more Secretaries, and such other officers, if any, as may be designated by the Board of Directors. At December 31, 2004, the Company's principal officers and their respective titles are as follows:

Officer	Title
Andrew A. Barnard	Chief Executive Officer
James E. Migliorini	President & COO
Peter H. Lovell	Senior Vice President, General Counsel & Corporate Secretary
Anthony J. Slowski	Senior Vice President & Controller
Robert S. Bennett	Executive Vice President & Chief Actuary
Thomas D. Corteville	Senior Vice President & CFO
Christopher L. Gallagher	Executive Vice President
Seymour L. Andrew	Senior Vice President
James J. Danbrowney	Senior Vice President
Michael P. Glesson	Senior Vice President
Stephen L. Porcelli	Senior Vice President
Jeffrey M. Rubin	Senior Vice President
Jean M. Willig	Senior Vice President

INSURANCE HOLDING COMPANY SYSTEM

The Company is a member of an Insurance Holding Company System under the ultimate parent company, Fairfax, a Canadian Company. Fairfax is traded on the Toronto and New York stock exchanges under the ticket symbol "FFH". Fairfax conducts insurance and reinsurance business globally in all segments of the property/casualty industries. At December 31, 2004, Fairfax owned 80.87% of Odyssey Re Holdings Corp., a publicly traded (NYSE _'ORH') Delaware holding company that indirectly owns 100% of the company.

The following chart of which Hudson Insurance Company is part identifies the relationships between its parent, affiliates and subsidiaries as of December 31, 2004.



v = voting control **o = ownership control**

(1) through voting and ownership control, both directly and indirectly, of the following individual and entities: Mr. V. Prem Watsa, 1109519 Ontario Limited, 810679 Ontario Limited and The Sixty Two Investment Company Limited
(2) calculated as 3,974,780 votes (3,974,780 subordinate common shares held) divided by 30,822,759 votes [See (8)]
(3) calculated as 3,974,780 subordinate common shares held / 15,342,759 total subordinate common shares times $1,781,800,000 / $1,918,400,000 [See note (8)]
(4) calculated as 0.8% through V. Prem Watsa and 50.4% through The Watsa Family Trust and the three entities described in (1). The 0.8% is calculated as 159,735 subordinate voting common shares (159,735 votes) through 810679 Ontario Limited and 96,568 subordinate voting common shares (96,568 votes) held personally by Mr. V. Prem Watsa, which equals 256,303 votes divided by 30,822,759 total votes. The 50.4% is calculated as 50,620 subordinate voting common shares (50,620 votes) plus 1,548,000 multiple voting common shares (15,480,000 votes) held through The Watsa Family Trust, 1109519 Ontario Limited and The Sixty Two Investment Company, which equals 15,530,620 votes divided by 30,822,750 total votes. [See note (8)]
(5) calculated as 306,923 subordinate common shares held (256,303 plus 50,620 [See (4)]) / 15,342,759 total subordinate voting common shares times $1,781,800,000 / $1,918,400,000 [See note (8)]
(6) 100.0% minus 12.9% (2) minus 51.2% (4)
(7) 100.0% minus 24.1% (3) minus 1.9% (5)
(8) common shares are publicly traded on the Toronto Stock Exchange in Canada and the New York Stock Exchange in the U.S. under the symbol "FFH". The Company has issued at 12/31/04 1,548,000 multiple voting common shares (which carry ten votes per share), 15,342,759 subordinate voting common shares (which carry one vote per share) and 8,000,000 non-voting preferred Series A shares. Total votes then consist of the 15,480,000 votes attributable to the multiple voting common shares and 15,342,759 votes attributable to the subordinate voting common shares or a total of 30,822,759 in all. Fairfax's capital account at 12/31/04 totals $1,918,400,000 (U.S.) which consists of common shares totaling $1,781,800,000 (92.9% of the total) and preferred shares totaling $136,600,000 (7.1% of the total).
(9) 0% ownership and 0% voting control but entity holds non-voting preferred shares issued by Fairfax S.a.r.l.
(10) Other than Southeastern Management, Inc. [see (2) and (3)] , no other entity or individual owns or controls greater than 10% as of 12/31/04, but as of 3/31/05, Goldman Sachs owned 1,800,176 subordinate voting common shares, which represented 5.8% voting control (1,800,176 divided by 30,822,750 total votes) and 10.9% ownership control (1,800,176 divided by 15,342,759 times $1,781,800,000 divided by $1,918,400,000).

It was noted during our review that the Company's filed annual statement did not reflect the proper ownership percentages. Subsequent to the examination the error regarding ownership percentages was corrected. Voting percentages, however remain undisclosed, and should be disclosed on the holding company chart. Therefore,

It is recommended that the Company properly disclose the Holding Company voting structure in the filed Annual Statement.

It was observed that Southeastern Asset Management Inc. had filed and received a disclaimer of control and exemption under Section 5003 (e) (2) regarding control of greater than 10% of the securities of FFH. This filing was accepted by the Delaware Department of Insurance on November 22, 2004. Southeastern Asset Management was identified in the 2004 Holding Company Registration Statement as controlling more than 10% of the voting stock of FFH [statement claimed 25% but actual was 12.9% voting control and 24.1% ownership control]. V. Prem Watsa, who had 51.2% voting control of FFH and 1.9% ownership control of FFH, was identified in the holding company registration statements for the years under examination as the “Chairman” of the ultimate controlling entity FFH.

Subsequent to the examination date, another entity, Goldman Sachs, had amassed 5.8% voting control of FFH and 10.9% ownership control of FFH during the first quarter 2005.

GROWTH OF THE COMPANY

The following information was obtained from the Company’s filed Annual Statements and covers the period from the prior examination to December 31, 2004, and reflects changes made for the current examination:

Year	Net Written Premiums	Assets	Liabilities	Surplus as Regards Policyholders	Net Income
2002*	$35,297,325	$81,768,825	$60,942,506	$20,826,319	($3,955,159)
2003	67,854,643	153,775,136	103,182,536	50,592,600	(589,645)
2004*	102,787,730	219,950,975	140,874,691	79,076,284	3,670,164

* Amounts per examination

The growth over the examination period has taken the form of the following:

- A 169% increase in admitted assets
- A 131% increase in liabilities
- A 191% increase in net premiums written
- A 166% increase in surplus as regards policyholders

Assets increased due to premiums written and surplus contributions. Net premiums written increased due to an increase in direct premiums written and a decrease in business ceded. Liabilities increased as a result of premiums written. Surplus increased due to surplus contributions.

TERRITORY AND PLAN OF OPERATION

Territory:

The Company is licensed to transact business in the following states, territories, possessions etc.:

Alabama	Iowa	North Carolina
Alaska	Kentucky	North Dakota

Arizona	Louisiana	Ohio
Arkansas	Maryland	Oklahoma
California	Massachusetts	Oregon
Colorado	Michigan	Pennsylvania
Connecticut	Mississippi	Rhode Island
Delaware	Missouri	South Carolina
District of Columbia	Montana	South Dakota
Florida	Nebraska	Texas
Georgia	Nevada	Utah
Hawaii	New Hampshire	Virginia
Idaho	New Jersey	Washington
Illinois	New Mexico	West Virginia
Indiana	New York	Wisconsin
		U.S. Virgin Islands

The Company wrote 18% of its business in New York and 43% of its business in California.

Plan of Operation:

The Company is part of the Odyssey Re Holdings Corp. (ORH). The Group provides a full range of property and casualty products on a world wide basis. Hudson is the primary vehicle through which ORH writes direct business. Hudson operates as an admitted carrier.

The Company participates in Program business written through specialized general agents. These contracted agents write on Company paper business that meets its underwriting guidelines.

Program Business:

The following table lists the five largest programs by premiums, in the year 2004.

Program	Gross Prem Written	Coverage	Territory
Affinity	48,705,000	Other Liability	Alien
Guardian	44,377,000	Private Passenger Auto	CA
Hooghius	20,668,000	Directors and Officers Liability	CA, CO, DE, GA, IA, IL, MD, MI, NJ, NY, OH, OR, PA, UT
Cabrillo	24,606,000	Private Passenger Auto	CA
National City Service	19,289,000	Private Passenger Auto	NY

INTERCOMPANY MANAGEMENT AND EXPENSE SHARING AGREEMENTS

Expense Sharing Agreement

As of January 1, 2000, Fairfax Inc., Odyssey America Reinsurance Corporation, Clearwater and Hudson entered into an expense sharing agreement. The agreement called for is each company to make available to the other companies management, underwriting, claims, accounting, financial, legal, personnel, data processing services and consulting, to be used at times and in amounts determined necessary or appropriate by the managing officers of each company.

Tax Allocation Agreement

Effective June 19, 2001, Fairfax Inc., Odyssey Re Holdings Corp., Odyssey America Reinsurance Corp., Clearwater, Hudson, Clearwater Select Insurance Company and Hudson Specialty Insurance Company entered into a tax allocation agreement. Under the agreement, the affiliated group exercises the privileges granted under Section 1501 of the Code to file a consolidated return. Each company's tax liability is calculated based upon its respective share of consolidated income. The agreement further provides that each member shall receive reimbursement to the extent that their losses and other credits result in a reduction of the current year's consolidated tax liability, not to exceed their liability as if filed on an individual basis.

Investment Management Agreement

The Company entered into an investment agreement with Hamblin Watsa Investment Counsel Ltd and Fairfax Financial Holdings Limited effective January 1, 2003. The agreement calls for Hamblin Watsa Investment Counsel to manage on a continuous basis the Company's investment account in accordance with the investment objectives communicated in writing by Company management.

REINSURANCE

A schedule of the Company's premiums follows:

Direct		$237,939,667
Ceded:		
Affiliates	31,633,862	
Non-Affiliates	103,518,075	
Total ceded		135,151,937
Total net premium		$102,787,730

The Company does not assume any business.

The Company cedes, per various quota share policies, amounts up to 75% of the original amount on policies written up to a limit of $1,000,000. On amounts greater than $1,000,000 the

Company's pro rata reinsurance is supplemented by the use of excess of loss reinsurance on specific lines of business.

ACCOUNTS AND RECORDS

The accounts and records reviewed included an evaluation of the Company's operation and organization controls. The areas evaluated included computer systems, accounting systems, organization structure and the processing structure. The Company operates in a computer dominated environment. The records of the Company are kept by an affiliate, Odyssey America Reinsurance Corp. per an expense sharing agreement. The companies use the "Great Plains" software for the general ledger application. The Great Plains software consists of multiple modules including Fixed Assets, Accounts Payable and Integration Management as well as other financial reports including a trial balance report that is utilized by the Company. A review of the Company's computer environment indicated the following deficiencies.

The Company does not have formally documented standards or operations procedures manual. Comprehensive documentation is critical to upholding high standards for quality and performance and reducing the cost of system and programming maintenance. These controls help ensure that accurate and relevant documentation is prepared for all new systems and for changes to existing systems and/or programs. Maintaining comprehensive documentation is critical to maintaining standards and quality and the documentation should be continuously reviewed to ensure that it is up to date and accurate.

It is recommended the Company formally develop a standard operations procedure manual. The manual should contain standard procedures for IT operations, to include all network operations. All IT solutions and platforms in place should be operated using these procedures.

In addition, the procedures manual should be reviewed periodically to ensure effectiveness and adherence.

The Company does not have a formal computer maintenance schedule and therefore runs the risk of diminished performance and reliability of computer systems.

It is recommended that the Company develop a schedule of planned computer maintenance to help protect its information technology investment and to reduce the risk of downtime.

The Company has not documented its system software selection and option review procedures. Without adequate system software selection and option review procedures, the risk of implementing system software that does not meet the Company's needs is increased. In addition, the risk of implementing system software that was not adequately tested or reviewed before being moved into the live environment increased. This could result in delays in identifying and correcting production problems or operational failures.

It is recommended the Company develops and document system software selection and options review procedures for reference and to ensure standard procedures are used to identify, select, program, test, implement and control system software. These procedures should include written management approval and appropriate standards regarding test procedures.

The Company has not documented procedures for network infrastructure changes. Without a documentation procedure, changes to the network infrastructure could be made without fully being aware of the impact to the applications, systems and network. Also, changes to the network could be made without proper or adequate preparation, resulting in system outages or reduced functionality.

It is recommended that the Company document the procedures for making any network infrastructure changes. This will ensure that all changes that need to be made are reviewed and approved by appropriate

management. This should also provide consistent analysis for each change or upgrade, and require that proper operational impact studies be made.

The Company does not have formal emergency response procedures to follow if a computer security incident occurs. Without adequate security response procedures, there is an increased risk of gradual or sudden degradation of Company systems or the risk of misappropriation of Company funds or the risk of confidential information being made public.

It is recommended the Company develop formal emergency response procedures to follow if a computer security incident occurs. These procedures should be communicated to all employees and contain specific instructions for employees to follow if a computer security incident occurs.

As part of the review of Cash and Cash related items an inquiry was made to the Company regarding its procedures for escheating monies to States. The Company disclosed that they do not have a procedure in place at the present time but one is being developed and will be put in place as soon as possible.

It is recommended that the Company complete the development of the process to escheat funds to the States as soon as possible. The Company's implementation should include procedures for handling outstanding checks.

FINANCIAL STATEMENTS

The following financial statements as determined by this examination are presented herein:

Analysis of Assets as of December 31, 2004
Liabilities, Surplus and Other Funds as of December 31, 2004
Underwriting and Investment Exhibit – Statement of Income For the Year Ended December 31, 2004
Capital and Surplus Account for the one year period ended December 31, 2004
Summary of Examination changes
Examination Adjustments

Analysis of Assets
As of December 31, 2004

	Assets	Nonadmitted Assets	Net Admitted Assets	Note
Bonds	$ 78,108,811	$ -	$ 78,108,811	1
Common stocks	1,779,007		1,779,007	
Cash, cash equivalents and short-term investments	75,730,320		75,730,320	
Receivable for securities	260,980		260,980	
Investment income due and accrued	1,404,077		1,404,077	
Premiums and considerations:				
Uncollected premiums and agents balances in course of collection	5,089,441	604,712	4,484,729	
Deferred premiums, agents balances and installments booked but deferred and not yet due	33,746,324		33,746,324	
Reinsurance:				
Amounts recoverable from reinsurer	20,488,600		20,488,600	
Net deferred tax asset	5,448,321	1,863,568	3,584,753	
Electronic data processing equipment and software	454,635	368,376	86,259	
Furniture and equipment including health care delivery assets	149,013	149,013		
Receivable from parent, subsidiaries and affiliates	277,115		277,115	
Other assets non-admitted	418,442	418,442		
Totals	$223,355,086	$3,404,111	$219,950,975	

Liabilities, Surplus and Other Funds

			Note
Losses	$	53,064,253	2
Loss adjustment expenses		2,248,057	2
Other expenses		1,043,177	
Taxes, licenses and fees		1,516,099	
Current federal and foreign income taxes		1,152,415	
Unearned premiums		45,750,620	
Ceded reinsurance premiums payable		16,213,158	
Funds held by company under reinsurance treaties		16,543,074	
Amounts withheld or retained by company for account of others		7,308	
Provision for reinsurance		966,951	
Drafts outstanding		292,625	
Payable to parent, subsidiaries and affiliates		2,076,954	
	$	140,874,691	
Common capital stock		7,500,000	
Gross paid in and contributed surplus		57,225,000	
Unassigned funds (surplus)		14,351,284	
Surplus as regards policyholders	$	79,076,284	
Total	$	219,950,975	

Underwriting and Investment Exhibit: Statement of Income
For the Year Ended December 31, 2004

Underwriting Income			Note
Premiums earned	$	89,055,365	
Deductions:			
Losses incurred	$	49,639,342	
Loss expenses incurred		8,499,754	
Other underwriting expenses incurred		26,569,142	
Total underwriting deductions	$	84,708,238	
Net underwriting gain or (loss)	$	4,347,127	
Investment Income			
Net investment earned	$	3,554,900	
Net realized capital gains or (losses)		937,633	
Net investment gain (loss)	$	4,492,533	
Net income before federal income taxes	$	8,839,660	
Federal and foreign income taxes		5,169,496	
Net income	$	3,670,164	
Capital and Surplus Account			
Surplus as regards policyholders December 31, 2003	$	50,592,600	
Net income	$	3,670,164	
Change in net unrealized capital gains or (losses)		(102,557)	
Change in net deferred income tax		1,967,046	
Change in nonadmitted assets		(2,013,080)	
Change in provision for reinsurance		(37,889)	
Surplus adjustments:			
Paid in		25,000,000	
Change in surplus as regards policyholders for the year	$	28,483,684	
Surplus as regards policyholders, December 31, 2004	$	79,076,284	

Examination Adjustments

No adjustments were made as of a result of this examination.

NOTES TO THE FINANCIAL STATEMENTS

Note 1

Bonds **$78,108,811**

Investments in bonds are reported at values (amortized cost) adopted and approved by the Securities Valuation Office (SVO) of the NAIC. Bonds owned by the Company are as follows:

US Government	$71,002,319
States, territories and possessions	538,855
Industrial and miscellaneous	6,567,637
Total	$78,108,811

Bonds are designated by the SVO with the highest quality being "1" and lowest being "6". The bond designations are as follows:

1	$ 77,569,956
2	538,855
	$78,108,811

Bonds with carrying values of $12,946,952 were on deposit with various states, or governmental insurance departments in compliance with insurance laws.

The Company did not have any securities on loan.

Note 2

Loss Reserves	**$53,064,253**
Loss Adjustment Expense Reserves	**2,248,057**

Loss and loss adjustment expense reserves represent 39.3% of the Company's liabilities as of December 31, 2004. Incurred but not reported reserves (IBNR) constituted 73.1% of loss reserves at year-end 2004.

INS Consultants, Inc. (INS) was retained by the Delaware Insurance Department to conduct a review of the Company's reserve methodologies and adequacy. INS evaluated the Company's book of business by line of business for loss and allocated loss adjustment expenses. The conclusions reached by INS are largely based upon information supplied by the Company's staff, which included an in-depth actuarial analysis. The INS reserve analysis was performed on both a gross and net basis of reinsurance and did not address the collectibility of reinsurance recoverables. The INS reserve review found the Company's combined net loss and loss adjustment expense reserves were adequate to support the business underwritten.

The underlying data was tested through a review of open and paid claim files and actual payments made with no exceptions noted. The aggregated actuarial data provided by the Company was verified and reconciled to Schedule P of the Company's filed annual statement.

Loss and LAE reserves are subject to errors of estimation arising from the fact that the ultimate liability for claims evaluated as of the valuation date are dependent on future contingent events which cannot always be anticipated. The possible occurrence of such events, as well as the inherent uncertainty associated with statistical estimates, allows no guarantee that the actual ultimate liabilities will be the same as the reserve levels described in this examination report. As a result of this study, the reserves were accepted.

COMPLIANCE WITH PRIOR RECOMMENDATIONS

The following recommendations were made in the prior examination report.

- It is recommended that The Board of Directors approve investments.

The Company has complied.

- It was recommended that the Company maintain an automated accounting system integration with the receipt of data from its agents to facilitate the reconciliation of general ledger balances to detailed source tabulations that include; open receivable and payable balances, unearned premium reserves, and loss and claim data that is necessary for reporting accurate information in the Annual Statement.

The Company is still in the process of developing an integrated system with program directors (producers). The Company has no timetable for implementation of such a system.

- In dealing with MGAs the prior examination recommended that the Company require MGAs to obtain the required Delaware license for business produced in and outside the State of Delaware.

The Company has complied.

- It was recommended that the Company enter into an agreement with its MGA and a bank utilized by the MGA, for the purpose of establishing a fiduciary separate premium trust fund in the name of the Company and in a bank that is a member of the Federal Reserve System.

The Company has complied.

- It was recommended that the Company, on claims settled by an MGA or open for greater than 6 months, have a copy sent to the their claims department.

The Company has complied.

- It was recommended that interim profits will not be paid to the MGA until 1 year after they are earned for property insurance business and 5 years after they are earned on casualty business and not until the profits have been verified.

The Company has complied.

- It was recommended that the Company provide the Commissioner, at least annually, an independent certified public accountant's financial examination report of each MGA with which it has done business.

The Company has complied.

- It was recommended that the Company periodically, or at least semiannually, conduct an on-site review of the underwriting and claims processing operations of its MGA.

With one exception the Company has complied.

SUMMARY OF RECOMMENDATIONS

- It is recommended that the Company properly disclose the Holding Company voting structure in the filed Annual statement. Page 10
- It is recommended the Company formally develop a standard operations procedure manual. The manual should contain standard procedures for IT operations, to include all network operations. All IT solutions and platforms in place should be operated using these procedures. In addition, the procedures manual should be reviewed periodically to ensure effectiveness and adherence. Page 15
- It is recommended that the Company develop a schedule of planned computer maintenance to help protect its information technology investment and to reduce the risk of downtime. Page 16
- It is recommended the Company develops and document system software selection and options review procedures for reference and to ensure standard procedures are used to identify, select, program, test, implement and control system software. These procedures should include written management approval and appropriate standards regarding test procedures. Page 16
- It is recommended that the Company document the procedures for making any network infrastructure changes. This will ensure that all changes that need to be made are reviewed and approved by appropriate management. This should also provide consistent analysis for each change or upgrade, and require that proper operational impact studies be made. Page 16

- It is recommended the Company develop formal emergency response procedures to follow if a computer security incident occurs. These procedures should be communicated to all employees and contain specific instructions for employees to follow if a computer security incident occurs. Page 17
- It is recommended that the Company complete the development of the process to escheat funds to the States as soon as possible. The Company's implementation should include procedures for handling outstanding checks. Page 17

CONCLUSION

As a result of this examination, the financial condition of the Hudson Insurance Company, as of December 31, 2004, was determined as follows:

Description	12/31/04 Current Examination	12/31/02 Prior Examination	Changes Increase (Decrease)
Assets	$ 219,950,975	$ 81,768,825	$138,182,150
Liabilities	$ 140,874,691	$ 60,942,506	$ 79,932,185
Common capital stock	7,500,000	7,500,000	0
Gross Paid in and contributed capital	57,225,000	2,225,000	55,000,000
Unassigned funds (surplus)	14,351,284	11,101,319	3,249,965
Total surplus as regards policyholders	79,076,284	20,826,319	58,249,965
Totals	$ 219,950,975	$81,768,825	$ 138,182,150

Since the last examination, the Company's assets have increased $138,182,150, liabilities have increased $79,932,185 and capital and surplus increased $58,249,965. In addition to the undersigned, acknowledgement is made of the assistance provided by the Delaware Insurance Department, INS Consultants Inc. and INS Insurance Services.

Respectfully submitted,

Richard Randour

Richard Randour, CFE
Examiner In-Charge
State of Delaware